

**JOHN CUNNINGHAM'S LLC NEWSLETTER
FOR TAX AND LEGAL PROFESSIONALS**

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**FOUR QUESTIONS PEOPLE ARE ASKING ABOUT
CONVERSIONS OF CORPORATIONS AND LLCs TO
LIMITED LIABILITY PARTNERSHIPS TO AVOID
WORKERS' COMP COVERAGE**

Dear subscribers to my LLC newsletter:

As many of you will know, this morning I distributed a newsletter about the substantial new workers' comp burdens that are being imposed on many New Hampshire companies in the building trades as a result of an amendment to RSA 281-A:18-a (which I'll refer to here as the "Amendment"). I stated in that letter that these corporations and LLCs can avoid the effect of the Amendment if they convert to limited liability partnerships ("LLPs"). Many subscribers have sent me questions about my newsletter by e-mail or phone. Set forth below are:

- The four principal questions people are asking me; and
- My answers to these questions.

Question 1. If I convert my corporation or LLC to an LLP in order to avoid the effect of the Amendment, how do I know that the New Hampshire Legislature won't just amend New Hampshire workers' comp law again next year to cover sole proprietorships and general partnerships (including LLPs)?

There can be no guarantee that the Legislature won't make these further amendments next year. However, there is already widespread and vociferous opposition to the Amendment, and there is a strong lobbying movement underway to repeal it. My bet is that as a result of all of this legislative activity, the Legislature won't want to expand the Amendment; and I'm even inclined to believe that it will repeal it.

Furthermore, if it costs a corporation or LLC legal, accounting and other expenses of, say, \$1,500 to convert to an LLP in 2007 and the Legislature does make the above amendments in 2008, the corporation or LLC will still be ahead of the game if the workers' comp premiums it saves in 2007 as a result of its conversion exceed the above expenses.

Question 2. Is it possible that if my corporation or LLC converts to an LLP to avoid the effect of the Amendment, the New Hampshire Department of Labor (the “DOL”) will nevertheless be able to impose workers’ comp coverage on the ground that the conversion is a sham?

There is no authority directly on point regarding this question. However, I am confident that the answer is no.

- Companies have the right to choose any business organization form they want for the conduct of their business, and, in particular, to choose the form that will provide them with the greatest business, legal and tax advantages. I’m not aware of any federal or state tax authority that has succeeded in disregarding such a choice as a sham, and I doubt the DOL will attempt such a ploy.

For example, many New Hampshire corporations have converted their business organization form to that of an LLC in order to obtain “charging order protections,” which are powerful statutory business asset protections that are provided by LLCs but not by corporations. To my knowledge, no federal or state tax or legal authority has ever tried to challenge these conversions. It should be noted that LLPs, like LLCs, provide charging order protections; and they also provide various other legal advantages that corporations don’t provide.

- LLCs, too, have the right to change their business organization form for valid business, legal and tax reasons. One advantage of the LLP form over the LLC form is that, since LLPs are essentially traditional general partnerships with a liability shield, they are covered by a vast body of partnership law—e.g., a classic partnership case by Justice Cardozo called *Meinhard v. Salmon*—on which LLPs may or may not be able to rely.

Question 3. My corporation is an S corporation (or a C corporation) for federal tax purposes. What will happen to its federal tax status if it converts to an LLP?

There is no federal tax authority directly on point on this question. However, it is absolutely clear under Internal Revenue Code Section 361(a)(1)(F) that if you convert your corporation to an LLC, this will be a “mere change of form” under that IRC section and that, accordingly, as long as you file an IRS Form 8832 and certain other IRS forms in connection with the conversion, your company’s status as a C or S corporation will remain intact—along with its taxable year, its loss carryovers, and any other tax attributes that it may have. (I should note that because I often assist clients in this kind of procedure, I have all of the above forms readily at hand.)

Question 4. My LLC is an S corporation (or a C corporation) for federal tax purposes. What will happen to its federal tax status if it converts to an LLP?

Same answer as to Question 3.

If you have comments on this column or wish to contact me for any other reason, please send me an e-mail at lawjmc@comcast.net or give me a call at (603) 228-0125. If you’d like to visit my website, the link is www.llcformations.com.

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